IN fact

Profit Drivers – Operating Expenses

Operating Expenses

In the Fact Sheet series, "Understanding Profit Drivers" we focused on sales volume as one of the four profit drivers – another is **Operating Expenses.** These include items such as:

- Rent
- Labour
- Vehicles
- Administration
- Discretionary Expenses

Rent and labour are often the two major costs for most businesses. A good way to test the effectiveness of these costs is by expressing them as a ratio to the gross margin achieved. This way we can test to make sure that the trend month to month remains within an acceptable range despite staff roster variations.

For example, if labour costs for the month are $15,000 and our gross margin was $60,000 our ratio would be $4.00 of gross margin for every labour $ paid. Providing our gross margin % remains constant and reduction in the ratio could signal lower staff productivity. Conversely, an increasing ratio would tend to indicate greater

It is also important to group all expenses into key categories so that they can be tracked as a percentage of sale to enable good cost controls to be implemented through exception reporting.

We also need to understand that within our operating expenses we have fixed costs – costs we have to meet regardless of sales and variable costs which we only incur to make a sale. Fixed costs are such things as rent, insurance, while variable costs are packaging, casual labour, royalty fees and owner discretionary drawings.

In measuring these elements we need to ensure that as we grow sales fixed costs reduce as a percentage while variable costs remain at an acceptable percentage. That way revenue gains actually flow into increased profits and do not get absorbed by inefficiencies as the business grows.

See the series of IN Fact Sheets to understand how the various Profit Drivers can be used to drive greater returns.

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